

Nov. 12, 1992

LETTER 1108

Question: OK, great, it's over. Bill Clinton will be our new president. Al Gore will be our new vice-president. Hillary Clinton will be a new "White House power center." Look at it this way -- we've finally got a president and a Congress of the same "persuasion," so let's see what those Dems can do.

Clinton has said that he'll hit the ground running, and he's promised us that he'll be the president of "change." Clinton's been talking incessantly about getting the economy going again, and, of course, if he can pull that off -- well that alone would be one heck of a change.

Question: How will Clinton fire up the American economy?

Answer: It seems that part of Clinton's plan will be to spend up to \$30 billion to re-stimulate the economy. But suppose Clinton decides to spend a lot more, and suppose his Democratic Congress (part of "the 100-day honeymoon") gives him what he wants. Then what?

First of all, I don't think spending \$30 to \$40 billion more in an economy as big as our's is going to make that much difference. But there's something else to remember -- today, more so than ever before, we've got "a tough cop on the corner." That cop is the bond market. If Clinton decides to spend more than the money markets think is "reasonable," then bonds are going to swoon, and interest rates are going to head up.

Clinton has to be aware of this, and he has to know that what he can do to stimulate the economy is limited. I think what Clinton would like to do is basically take from the so-called "rich" and spread the spoils around to what he calls "the middle class." After all, the millionaires don't have the votes, the great mass of votes come from people making \$50,000 or less.

Remember, a few years back the guys in Washington took away almost all our tax breaks and writeoffs in exchange for a trade-off? The trade-off was a slight decrease in the income tax rate. Now with all our tax breaks gone, Clinton wants to boost our taxes. On top of this, the states (almost all of them) plan tax increases. Whether this kind of action will create prosperity in America is a moot question. But what the heck, Bush screwed up, so it's only fair to give the Dems a shot at screwing up as well.

Question: What do you really think Clinton's going to do?

Answer: What Clinton's "promises" boil down to are a national health program, a universal college scholarship program, an all-out war on AIDS, plus a middle class tax cut, all the while cutting the federal deficit in half. Mmmmm.

I don't know about all the above, but I do see higher taxes coming on incomes over \$200,000. Also (this is really cute), there's a proposal in Congress to lower the \$600,000 death tax exemption to \$200,000. Furthermore, there's another Congressional proposal to cap your annual tax free giving to \$30,000 (the law now says you can give a \$10,000 tax free gift to as many people as you want). In other words, these proposals would have you die with as much money liable to government taxes as possible -- and remember, they're talking about the money you've saved, the money you've already paid taxes on. **Russell suggestion** -- give it away now before the government relieves you of it -- and believe me, don't doubt it for a moment, they mean to relieve you of it.

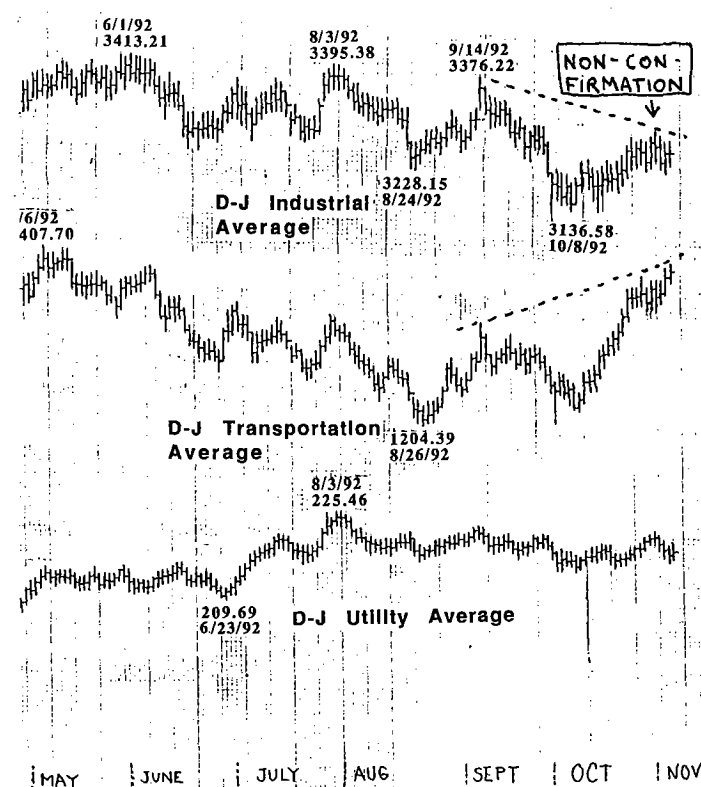
Oct. 30 DJIA 3226.28; PTI 3585; A-D Ratio -9.99
Nov. 6 DJIA 3240.06; PTI 3590; A-D Ratio -9.92
Dow Yield: 3.20%; Dow Price/Earnings: 43.5
Dow 200-day MA: 3290; Dow 30-day MA: 3211
Dow Times Book Value: 2.48; PTI 89-day MA: 3547
Percentage of Undervalued Blue-chips: 10%
Low Risk Buy Index: 125

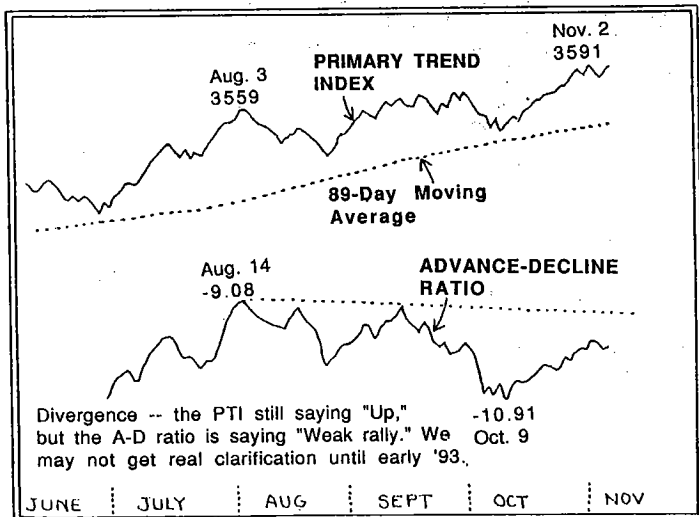
Question: Russell, you've said repeatedly that "all primary movements are international in scope." If that's true, why hasn't the US market been more adversely affected by what's been happening around the world?

Answer: What we are seeing now is a world economic contraction. Actually, that's a rather polite term for it. The real term is "global depression." From Germany to Japan, from Britain to Russia, the word is rotten business, declining profits, sharply rising unemployment.

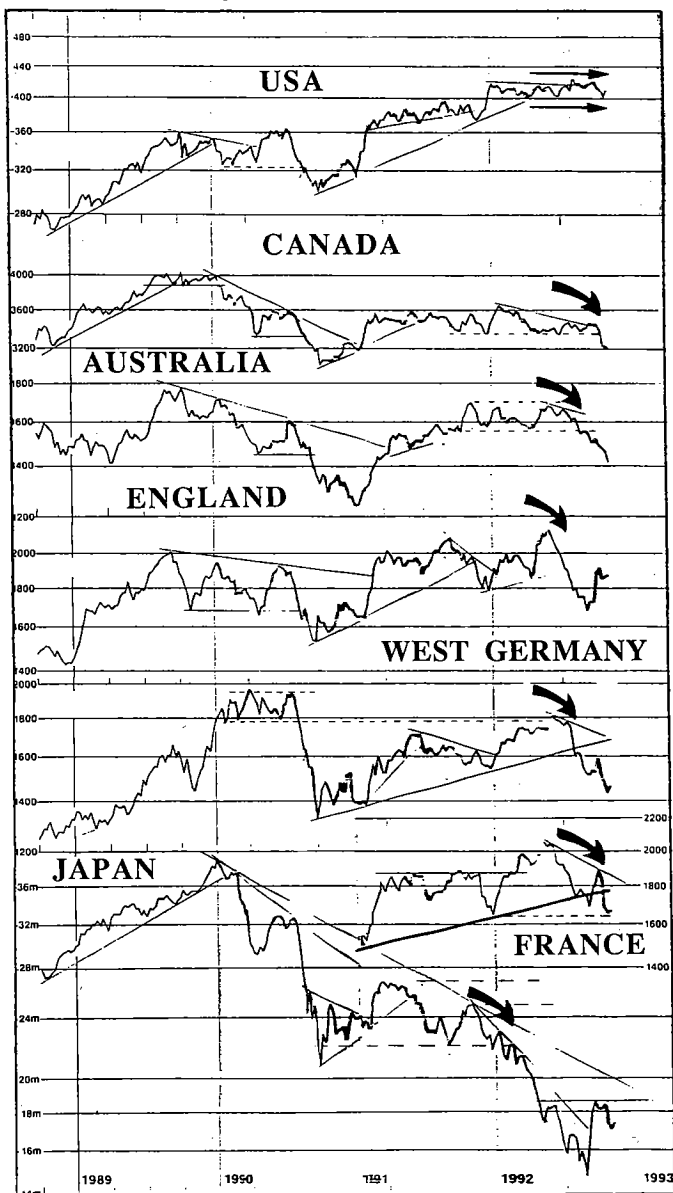
Exports have been the one saving grace for the US economy. Up to now (partly due to the cheap dollar) this has been the single growth area in the US economy. For instance, the US trade gap declined from \$102 billion in 1990 to \$65 billion in 1991. But with most of the world in recession and with a higher dollar, that's now changing. The latest (August) figure shows the trade gap running at the rate of \$108 billion a year. Quite a change.

What about markets? On page 2 I have included a chart published by my good friend, Ian McAvity (*Iris Ltd.*, PO Box 43310, Tucson, AZ 85733). Here we see all the major stock markets of the world in bear trends -- with the single exception of the US market. How can this be?





There's no single easy answer. But one reason may be that the Fed has manipulated US rates to extreme lows, thereby driving thousands of income-hungry US investors into stocks and bonds. Furthermore, the US on a business cycle basis seems to be running behind Europe and far behind Japan. However, it is also true that a great many US stocks have already been hit and hit hard. The broad Value Line Composite Average, for instance, has never returned to its 1987 high.



Nevertheless, the interesting fact is that the major averages and indices in the US have been going sideways all year, and as this is written they are still not far from their record highs. Ironically, the Japanese market, which led the world on the upside from the 1950s through the 1980s, is the market which has taken the worst beating (of course, it was also the most overvalued).

As I see it, it is only a matter of time before the US market joins the rest of the world's markets to the downside. Market's don't perform in line with what we expect or what we would like. They move to their own rhythm and on their own time. In a way, I guess that's what's so fascinating (and difficult) about markets.

Question: The Dow dropped about 260 points to its low on October 9. From there we had a fairly persistent rally into the election period. What do you make of that action?

Answer: First, let me repeat the old adage that the reason for a market move is seldom known at the time. Certainly, the secondary movements that come within the broad primary movements are extremely difficult to analyze (often, they are strictly technical, such as relieving an oversold or overbought situation).

If pressed to provide an explanation for the current situation here's what I'd say: "A primary bear market began back in February. That was the point where the market decided that it had fully discounted the best that could be seen ahead. Once the best is discounted in the price structure, the market is ready to be taken over by the bear."

I think that the stock market around February perceived that Bush was failing, at least failing in the eyes of the American people. That meant the coming of a Democratic administration and a "tax and spend" type of president. On that basis, the worried market headed down, hitting a low on April 8. From there the market corrected upwards and then turned down again. By October 5 the Dow was at a new low and so were the Transports.

From the oversold area of October 5, the Averages rallied, spurred on to some extent by the belief that Bush and the Republicans might, just might, engineer the unexpected and win the election.

And of course during all this period the Fed was lowering interest rates while frantically pumping reserves into the banking system. The Fed action softened the economic decline, and turned what what might have been a true depression into what some economists have termed, "a contained depression." And that's where we are now.

Question: Looking at the page 2 chart, I see that your **Primary Trend Index (PTI)** has been hitting new highs. How does this square with your Dow Theory interpretation?

Answer: I can't remember the PTI being at such variance with a Dow Theory signal, but I have a confession to make -- I don't make the market, I just follow it and try to interpret it.

I believe the primary trend of the market is down. But the new highs in the PTI were telling me that after the October 9 low the pressure was on the upside. Conclusion: The bear just hadn't dug his claws into the market yet.

I've often, in the past, referred to the PTI as my "fail-safe" indicator. Bull or bear market, the PTI indicates the immediate technical undertone.

The Dow Theory says "bear market," but the PTI says, "Maybe so, but not yet." To me that means being super-careful about buying or holding stocks, but it also means avoiding the short side.

I'll repeat this -- the bear market won't get going until the PTI heads down, breaks below its 89-day moving average, and continues down. And as this is written, we're just not there yet.

Question: Russell, I note on the **page 1** chart that the D-J Transportation Average has by a wide margin bettered its preceding peak of 1308.75 set on September 14. Yet the Dow is nowhere

near confirming -- to confirm the Dow would have to better its own September 14 peak of 3376.22. What do you make of this?

Answer: This could be a perfect spot for KISS ("Keep it simple, stupid"). Translated, let's say that we're simply seeing an upside non-confirmation. One of the rules of Dow Theory is that a penetration of one Average, not confirmed by the other, is meaningless for prediction purposes and often deceptive. So I think it's significant that the Dow has refused to confirm the superior performance of the Transports. And this kind of action is particularly significant during a bear market.

Question: Russell, you stated that the Averages gave a Dow Theory bear signal on October 5. If that's true, why hasn't the market fallen apart? After all, in a bear market stocks are supposed to go down, right?

Answer: That's right, in a bear market stocks are supposed to go down -- and they do. But they don't go down on your command or my command. And they don't go down when it's most convenient for investors.

Nothing is automatic where markets are concerned. The October 5 bear signal occurred at a time when the market was quite oversold. A bear signal should more properly be called a trend identifier rather than an actual signal. The fact is that the bear market didn't start on October 5 on the day of the bear signal, it started eight months earlier. The bear market started on February 20. That was the day when the D-J Industrial Average and the D-J Transportation Average recorded their last joint highs.

If you study any chart book you'll see that the majority of stocks on all exchanges have fared rather poorly since the February highs. In fact, I doubt whether anyone with a diversified portfolio has made any money since February. The majority of mutual funds also show negative action since February.

As the bear market wears on, stocks will fare poorly. I say that because values deteriorate during the course of a bear market. But stocks do not immediately have to reflect a deterioration of values. That can take time, often weeks or months.

Prices reflect investors' perceptions of conditions and values at any given time. It's rather fascinating to me that consumers' sentiment regarding the economy has dropped for four consecutive months. This pessimism has arisen even while stock valuations are at extremely high levels. It's an extraordinary paradox -- consumer gloom about the economy vs. extreme optimism regarding stocks.

Question: How do you explain this division between consumer pessimism and stock market optimism?

Answer: I've thought a lot about this seeming paradox, and here are my conclusions. Stocks have been selling at overvalued levels for the better part of the last five years. From an extreme of overvaluation in late-1987, stocks crashed. But within a year stocks had recovered. In 1990 stocks suffered a mini-crash, but again they recovered. Each recovery took stocks back to the overvalued area.

At this point I feel that the investing public is thoroughly "conditioned" to believe (1) that any decline, major or minor, will be followed by new highs in the stock market; and (2) that very high valuations for stocks (i.e., today's average dividend yields of 3%) are perfectly normal, perfectly safe, and indicative of what we can expect for years to come. This has generated a high degree of confidence among stock buyers, probably the highest extended period of "great confidence" in market history.

Question: Russell, how would you characterize the rally from the October 9 low?

Answer: I'd characterize the rally as strange, or maybe I should just call it weak. For instance, did you know that in all the days

since October 9 (advancing or declining days) there has not been a single day in which there were less than 600 declines. Furthermore, since October 9 we have seen just one day in which there were less than 37 new lows.

To me that indicates a weak rally, a rally in which there was a lot of distribution. It was very unusual action.

Question: In the last Letter you showed a chart and offered a technique that identified major low-risk buy areas. I note that we are still far away from a major low-risk buy area now. What do you make of this?

Answer: As long as this Index is above zero, it really isn't telling us anything of significance. It's when the index drops below zero that it gets interesting, because the Index is then in the territory where it can register a major low-risk buy signal. But it's a mistake to think that just because the Index is heading down, that this means the market is in trouble. What the currently declining Index is telling us is that the market is losing upside momentum.

One thing we can infer from the Low-Risk Index (which was at plus 125 at the end of October) is that we are NOT now at a great, low-risk buy area. But don't knock it -- this kind of knowledge is invaluable, particularly for long-term investors who only want to buy when they face the least possible risk of being wrong. This may sound naive, but buying correctly is one of the most profitable things you can do in investing.

Comments: The latest news from the St. Louis Fed has me doing a double-take. Since July 20 the M-1 money stock has expanded at a compounded annualized rate of 20.3%. Since July 8 adjusted reserves have expanded at a compounded annual rate of 20.6%. The Fed, it seems, has been almost frantically pumping up reserves in the hopes of getting Bush re-elected.

Then a week before the election the Commerce Dept. released the news that the GDP for the third quarter was up 2.7%. President Bush happily trumpeted the good news. "This is very encouraging for America," he cooed, "If you think I'm happy you're right." A number of economists opined that "the books were cooked," and there was widespread skepticism about the new "Bush numbers." Ah, in the end it really didn't matter.

Actually, I wrote a little poem. Here it is --

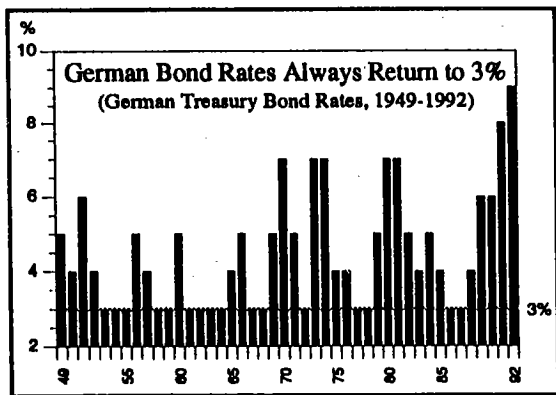
The end of the mystery,
Bush is history

The end of the tale,
Say "Good bye" to Dan Quayle

INVESTMENT POSITION: The bear's in the box, but he's been a sneaky bear. For instance, 25% of all stocks have lost over one-third from their peak value -- in other words, there's already been a lot of damage done. An advance-decline line of only common stocks (no preferred, no bond funds) shows a declining trend all year (it's currently just off its low). And a limited number of high-cap stocks have kept the "big averages" (including the Dow) going sideways all year, rather than down.



With US interest rates firming (preparing for a Clinton administration) and with German rates easing off, the dollar has rallied strongly against the market and other major currencies. The German bonds (bunds) have been hitting highs, but the weaker mark has wiped out any bund gains for Americans. This chart (courtesy of *Forecasts & Strategies*, 7811 Montrose Rd., Potomac, MD 20854) shows that German bond rates have, in the past, always dropped down to 3% (they are over 7% now). In time, I believe they'll drop to 3% again.



Personally, I'm content to watch this market. With a whole new administration coming in, there are a lot of cross-currents and a lot of hopes now being generated. I'm content to watch the show. By the first quarter of '93 I believe the bear will be in full command.

NOTES & QUOTES: Surprises: Well, Saddam Hussein out-survived George Bush (who would have believed that eight months ago?).

But wait -- this is even crazier. Could the formerly despised Chrysler outlast the once-mighty General Motors? Here's part of the story on GM. With a \$1.60 dividend on 690 million shares, GM was paying out \$1.1 billion in dividends (and with huge losses, GM was borrowing the money to do it). On top of that GM is paying out \$300 million on its preferred stock. Big problem: GM sold \$2.1 billion in common stock last spring. An omission of the dividends (which is really what GM should have done) would have brought lawsuits from those who just bought the common, so last week GM halved the dividends to 80 cents a year. Another huge problem: GM has a \$10 billion shortfall on its pension funds. The pressure is on at GM, and directors now want to cut 120,000 jobs during the '90s. Says a director, "It's going to be brutal, and if the unions won't cooperate, GM will have to play real hardball." Last year GM lost an astounding \$4.5 billion. Last week GM reported a loss of \$753 million for the third quarter. The thought is that GM has about three years to turn itself around and halt its massive losses. If it can't do that, there's talk of Chapter 11 bankruptcy.

Quote of the week (from Duncan Campbell-Smith, the London *Economist's* "main man in the US"): "There are two things that really strike an Englishman coming to New York City. The first is the wealth that is displayed so conspicuously on Wall Street, like Versailles under the Sun King. The second is the slight of people freezing and lying in the streets. The things that really count in this country are not Clinton meets Bush, but is IBM going to collapse in the next five years? Is General Motors going to disintegrate? Is Sears, Roebuck going to go bust? These are the things that will determine where America will be in the next century."

I don't know exactly why, but I'm receiving more and more letters from subscribers (maybe there's just more confusion out there). On some days I get as many as a dozen letters. A lot of people want personal advice, others want clarification of something I've said, and still others object to a thought or even my whole interpretation of the market. I can't answer most of these letters. I wish I could, but I can't. After my recent article in *Barron's* I was sent copies of letters to *Barron's*, mostly arguments about my interpretation of Dow Theory. *Barron's* people asked if I wanted to answer or refute the letters. I told them, "No, I said what I wanted to say, and I don't want to enter into a debate."

What I'd like to do is spend most of my time either thinking about the markets or writing about them. I also like to have some time to see my kids and grand-kids or to ride my motorcycle or to eat a peaceful dinner or to read the newspapers. Maybe it's a matter of how much energy I have as much as the time. At any rate, if I don't answer your letter, please don't hate me. It's nothing against you -- it's just that I don't have the time or energy.

Which brings me to another subject. Every once in a while I sit down and say to myself, "Russell, maybe if you were more ambitious, brainier, more single-minded, you could have been a zillionaire like Warren Buffet or Marvin Davis or hell, even like Ross Perot. But in my heart I know I'm kidding myself. First of all, I'm not obsessed enough. Nobody makes hundreds of millions by mistake. You've either got to be a genius in some area (Bill Gates in computer software) or ruthless (Ross Perot) or very lucky (also Bill Gates, believe it or not) or a master salesman (Lee Iacocca). You also have to take big chances, as almost all these gentlemen did.

So how badly did I want to be super-rich? Obvious answer: Not badly enough. Now mind you, I'm not saying that even if I was obsessed with amassing a huge fortune I could have done it. But without that obsession, forget it, you're not going to end up with \$300 million.

Consider Ray Kroc, the master hamburger salesman (he built McDonald's). Ray believed in hard, hard work. He said he knew dozens of PHDs who were unemployed; he said there were plenty of geniuses who were on welfare. No, said Ray, there's just no substitute for perseverance, hard work, single-mindedness and sweat. Ray Kroc knew what he was talking about.

Me, I wasn't willing to do that kind of work. I wasn't willing to travel the world selling something or other. I wasn't willing to drive my competitor into the ground, or to gamble everything I had on an idea. I tell myself I'm too nice a guy or I'm too honest.

But I can't complain. God gives you what you need, not what you want. Maybe Henry Kravis needs \$500 million (who am I to say he doesn't) and maybe Ross Perot needs two billion. I always got what I really needed, and I faced it long ago -- my fantasies of being a zillionaire are just that -- pure fantasy (but hey, at least my mother was proud of me).

Speaking of big money and taking chances, here's how it's done. The Hungarian-American financier, Henry Soros, made \$1.5 billion dollars a few months ago by borrowing and betting that the pound would not hold, and that it would have to pull out of the ERM and be devalued (it was subsequently devalued by 12%). But can you imagine borrowing billions to speculate on anything? The *Times of London* quoted Soros as saying, "Our total position by Black Wednesday had to be worth almost \$10 billion."

Sports: Nine baseball teams are now losing money. Estimates are that most are losing around \$2-4 million with the worst being the California Angels and the Milwaukee Brewers, both losing \$5 to \$10 million in '92. The owners are talking "salary caps" or revenue-sharing with the big city teams.

Faye and I went to the big San Diego Antique Motorcycle Show, and it was pretty amazing. I don't know whether nostalgia is taking over, or whether people are just fed up with today, but these restorations of ancient bikes is just fabulous. Some of the old Indians were for sale at prices up to \$26,000. One row of "pre-1920s bikes" was worth the price of admission alone. Also worth the price was the crowd (if you've never seen a motorcycle gathering, you've got a thrill coming).

Speaking of restorations, one of the hottest areas today is vintage World War II airplanes. Prices of these planes have gone through the roof. Said Bruce Redding who runs an annual auction at the Museum of Flying in Santa Monica, "I've been buying and selling planes for 20 years. The way the market has gone, I wish I still had every plane I've ever sold. P-51 Mustangs (about 150 remain) go for \$500,000 or better. A rare Vought Corsair (35 still around) goes for \$750,000. A still rarer P-38 Lightning recently sold for \$1.75 million. The word is that if anyone could find a flying Japanese Zero it could bring in at least \$2 million."

What's happening in China (in retrospect) is just as important as the US elections. The recent shake-up in the Chinese Politburo moves many hard-liners out and solidifies China's move towards capitalism (with dictatorship, of course). The news is that 8 of the

14 leaders in China's politburo will step aside. Personally, I think capitalism in China will result in an eventual easing of the dictatorship, and I think it would be a mistake for the US to play "too tough" with the Chinese at this point. The mover behind the whole Chinese situation is Deng Xiaoping, who is now being elevated (actually glorified) to the same status as the legendary Mao. The *People's Daily*, the party newspaper, recently spoke referentially of the Thoughts of Deng Xiaoping. Deng, when he dies, will probably be equated with a demi-god. But right now he's the force for "easing" in the new capitalist China.

What's the big "in" fad today? It's tattoos. On the beach here in La Jolla it seems every kid, boy or girl, has a tattoo somewhere or other. Some tattoos are hidden (I won't say where), but most are highly visible. The macho guys (many out of prison) have a slew of tattoos, often covering their chests or backs. But then I found out that tattooing is hardly something new. Churchill had an anchor on his right arm. Stalin had a death-head on his chest. Roosevelt wore his family crest on his bicep. John F. Kennedy sported a few off-color tattoos before Jackie demanded they be removed. Theodore Roosevelt had a tattoo as did Harry Truman, Marshall Tito, George V of England and Kaiser Frederic III.

Just got a call from a friend who is spending six months in the federal prison here in San Diego. He says it's worse than you can imagine. The prison population here is 85% Mexican, 10% white, 5% black. The Mexicans "run the prison." He says the word is, "Don't look anyone in the eye, don't borrow anything from anyone, don't lend anyone anything, and keep to yourself." The food? "The worst." How would you characterize the guys in the prison? "The scum of the earth." He added, "Don't even try to visit me, it can take up to four hours to get to see a prisoner. They don't try to make it easy on you here. The fact is that nothing's easy here." Russell advice: The above is just a small portion of what my friend told me. My advice -- don't do anything that will land you in prison. It's a lot worse than you've been led to believe.

When the Japanese take bribes, they don't kid around. In one of the biggest scandals in Japanese history, political king-maker Shin Kanemaru was recently caught taking a 500-million yen bribe and was forced to resign from parliament. He was the most influential member of the Liberal Democratic Party. Now the word is that the big Kanemaru probe may slow the approval of the new Japanese "stimulation" budget. In the meantime, opposition parties are calling for an investigation regarding links with Japan's organized crime and distributions of bribes to other politicians. All this is not helping the economic picture. Latest statistics show that corporate insolvencies in Japan increased 35% in September.

Sniff: If you're staggered by the odors wafting up from your favorite magazine, don't fight it. This year a record 56 new perfumes have been introduced, mostly in so-called page "strips." The cost of introducing a new perfume is huge, a minimum of \$7 to \$10 million, while spending of \$40 to \$50 million is not unheard of. Example: Jil Sanders new No. 4 perfume was introduced this year with 300,000 mailers and 16 million "strips" in magazine pages. Next year Sander's strips will hit 30 million. It's big business. How big? The total perfume market (men and women) is \$4 billion.

The Japanese are heading east. Japan and China announced that a consortium of Japan's six largest trading houses have agreed with Chinese authorities to build and operate a massive \$4 billion petrochemical plant in China. It would be the largest-ever joint Chinese/Japanese venture. The Japanese will have a 51% stake in the venture.

"How I lived with the federal deficit and learned to love it." Ah, finally the computers have it and they're turning it into fun. A new computer software game called "Hard Choices for Americans" allows you to reduce the federal budget your own way -- it instantly shows the effect of a cut in various areas.

The Feds still can't get honest about the true budget deficit. Two weeks ago they came out saying that the deficit was only \$293

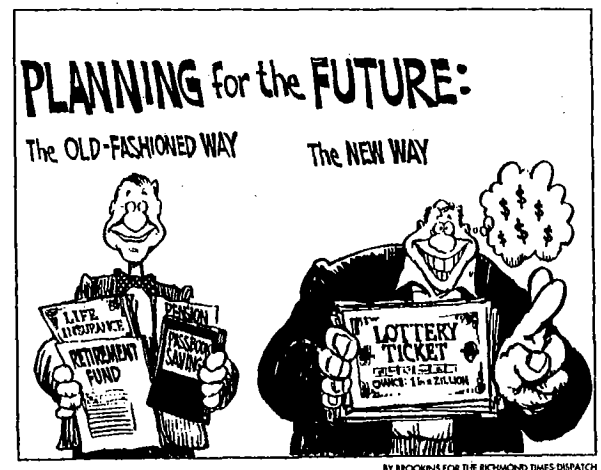
billion. But the fact is that this nation over the last 12 months added \$375 billion to the national debt. That's the real deficit -- anything else is a lie, pure and simple. If you can't even tell the truth about it, how are you going to cure it?

Hollywood is in a state of near-hysteria with studio heads and near-heads moving in and moving out. Expenses of making movies are so high today (along with very high distribution expenses) that every studio needs a "blockbuster" just to survive. So when they make a movie, they need insurance, and the only insurance they feel reasonably sure of is a star (of course, stars don't guarantee success, but what else is there?).

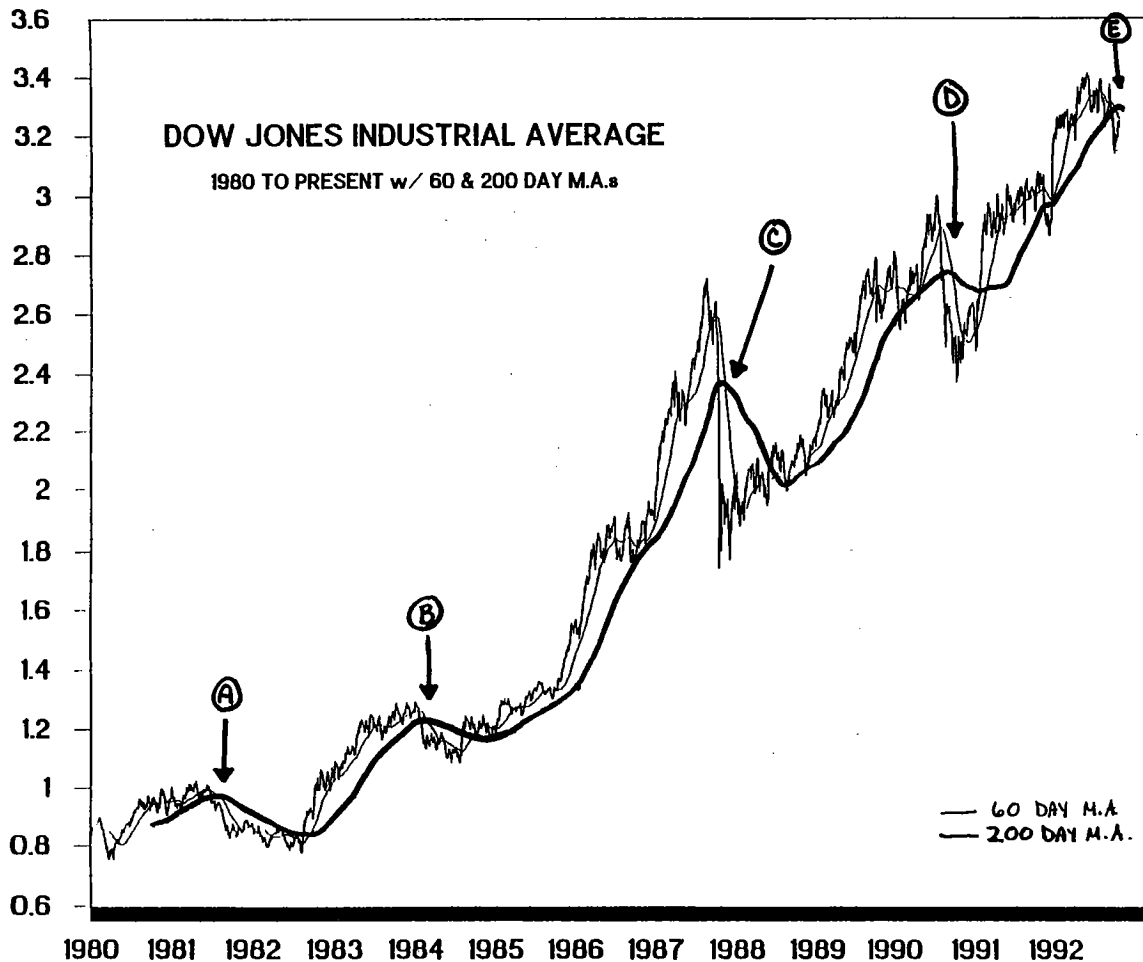
So the stars can ask for the moon. Here are some expenses for a forthcoming film, "A Few Good Men." For the screenplay: \$1 million plus an extra \$350,000 for script doctoring services. For Tom Cruise: \$12 million salary plus \$85,000 for his two drivers during the 17 weeks of shooting plus \$55,000 for Cruise's private plane. For Jack Nicholson: \$5 million. For Demi Moore: \$2 million. For Kevin Bacon: \$650,000. For Kiefer Sutherland: \$250,000. For director Rob Reiner: \$4 million. For make-up and hair almost \$300,000. For Moore's personal trainer: \$25,000. And this doesn't include distribution costs. Russell comment: If you are raising money to fund a big new movie, please don't call me.

This year appears to be ladies' year in the US. Along these lines, these are the richest ladies in Hollywood. Oprah Winfrey with a fortune of \$200 million. Barbra Streisand with \$180 million. Madonna with \$164 million. Mary Tyler Moore with \$160 million. Dolly Parton with \$158 million. Liz Taylor with \$150 million and diamonds. Jane Fonda with \$143 million and Ted Turner. Goldie Hawn with \$130 million. There, and I hope I haven't given away any secrets.

Today almost every state in the Union offers or condones some form of gambling. In a battle between morality and finances, it's obvious that finances have triumphed. So today, in the era of whopping debts and lowered standards of living, the future looks increasingly precarious. But at least one cartoonist has captured the spirit of the times. Have a look.



I gave up smoking back in 1971, but I can be wrong about tobacco. A few Letters back I talked about a government subsidy for tobacco farmers. My subscribers don't let me get away with a thing. Here's part of a letter just received from F.R. Pidcock, III out of Moultrie, GA. He's president of the Georgia Tobacco Warehouse Assoc., Inc., and he knows whereof he speaks. "There is NO tobacco subsidy! No farmer receives a single cent from the government for growing tobacco... The farmer even pays for the grading of his tobacco by the USDA/AMS at the rate of 70 cents a pound. The No-Net Cost Tobacco Program is paid for by an assessment levied on the producers and purchasers of tobacco. I might add that the government receives billion of dollars in tobacco revenue and the trade balance received billions in positive flow from tobacco products." Russell comment: I was wrong about the subsidies, but I still wish I could have back all those years when I was a smoker.



MOVING AVERAGES: One of the oldest technical studies of the market concerns itself with moving averages (usually of the Dow), and I've been writing about moving averages ever since I started these reports. You will note that for many years I've included the statistics for the 200-day and the 30-day moving averages of the Dow on page 1 of this Letter.

Last week I received the November 1 report from a very savvy veteran market analyst, Justin Mamis (courtesy of *Gordon Capital*, 767 Fifth Ave., NYC 10153). The report included a chart of the Dow, the 60-day moving average (light line) and the 200-day moving average (heavy line). The chart was so clear and so dramatic that I wanted to bring it to the attention of subscribers.

Says Mr. Mamis, "When the 60-day's intermediate term trend crosses the longer-term's 200-day moving average, it consistently identifies a very significant change in trend. This works for upside crossing as well . . . The key word is 'crossing,' as in the phrase, 'the 60-day has now crossed down through the 200-day.'"

The crossing of the 60-day above or below the 200-day has, in the past, been the signal for "change," (change word courtesy of Mr. Clinton), and as you can see on the chart, the last crossing (at E) was down.

It's been my observation that the longer the Dow holds above or below the 200-day moving average, the better the odds that the "signal" will be valid. Currently, the Dow has dropped low enough and held at a low level long enough that the 60-day MA has sunk below the 200-day MA. In the past, this has been "bad news" for the market. My guess: it will be bad news again.

GOLD: The Fed continues to pump up the money supply, hoping to re-inflate the debt-logged US economy. But followers of the so-called "long wave" believe that world deflation is upon us; and that

no amount of pumping can turn this tide. So I ask myself, "Can the long wave guys be right? Are we fated to see hyper-deflation before it's all over? And if so, what would gold do? If we really do experience hyper-deflation, I would think the world's financial structure (in view of the mountains of debt) would come unglued. If that happens, gold would serve as a store of value in a world of battered and suspect currencies.

Meanwhile, treat gold as part of a diversification and insurance plan. The US and world economy is becoming more and more like that dreaded description of Hollywood in which "Nobody knows anything."

LATE NOTES: In all the 40 plus years that I've been watching and studying the market, I've never seen stocks remain in the overvalued zone as long as they have in the current period. It's really remarkable, and I have to believe it has to do with

an extraordinary level of confidence on the part of today's investors.

In the 1950s or '60s a Dow yield around 3% (or certainly under 3%) would have struck fear into the hearts of investors. Not so today. Today, if the Dow or even the S&P yields 3% or less the figure is ignored, and stock buyers simply turn to the secondary stocks or to the NASDAQ, while analysts list reams of lesser known issues which are "undervalued" or in a "buy mode."

Is it a new game? Have the standards of value changed? I doubt it, but it's obvious that the low (Fed manipulated) level of interest rates have been a prime force behind today's overvaluation in stocks.

Price-wise, the best description of what's going on is "cross-currents" or just plain "confusion." Overriding all other immediate considerations, my PTI continues on its bullish path. But the advance-decline ratio on the NYSE (page 2) has been surprisingly sluggish on the rally. Day after day we see 600, 700, 800 declines, regardless of what the Dow does on the upside.

From a near-term Dow Theory standpoint the flagrant non-confirmation continues in force with the Dow refusing to confirm the Transports on the upside.

The decline in bonds which began in early September is becoming severe, and at the long end of the Treasury market over a dozen bonds are hitting the 7.75% to 7.80% level. The government tells us inflation is running at 2.5%. Normally, 3.5% is added on top of the inflation rate for the long bond rate. That's 6%, but at 7.8% the bond market is adding an extra 1.8%. That's what I call "the squeeze," and the stock market doesn't like it.

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